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SUBJECT: LATVIA: INFLATION TICKS UP TO 9.5 PERCENT IN JULY

REF: A) RIGA 166, B) RIGA 497

¶1. (U) According to Latvia's Central Statistical Bureau (LCSB), inflation in July increased 1.2 percent since June, bringing annual inflation up 9.5 percent year-on-year. Latvia's inflation rate is again the highest in the EU, according to the EU's Eurostat. LCSB reported higher prices for tobacco products, services related to housing, heat energy, and fruit had the biggest effect on inflation in July.

¶2. (U) Prime Minister Aigars Kalvitis responded to the latest numbers by pointing to the government's anti-inflation plan implemented last May (ref B) and said he wants to give the adopted measures more time to show results. However, a recent drop in the Prime Minister's popularity may indicate growing impatience and frustration among Latvians who have been facing ever rising prices. Food costs have become especially high, up 12.2 percent since July 2006, according to LCSB, and Kalvitis was booed when he appeared at a basketball game against Lithuania on August 4, something that no one can remember happening to a Latvian leader in recent years.

¶3. (SBU) Kalvitis faces two economic mileposts. One is the September adoption of the mid-year budget review. While the budget currently shows a roughly 500 million dollar surplus, there will be political pressure--especially from public education and health care sector workers--to spend some of it, despite the inflationary effect. Our contacts in the bureaucracy, though, say that they are being pressured to keep spending down. The second is the December parliamentary vote on the head of the Bank of Latvia. Current governor Ilmars Rimsevics wants to keep his job, but rumors have surfaced in the press that the PM may wish to see a less independent governor. Rimsevics, who has publicly supported the government's anti-inflation plan but in meetings with the embassy has admitted that the plan was the bare minimum the government could credibly propose, is well respected in international financial circles and his removal would do little to address rating agencies' concerns about the Latvian economy. President Valdis Zatlers has publicly supported the re-election of Rimsevics.

¶4. (SBU) Comment: The economic news is starting to bite politically and Kalvitis, who has a very laissez faire approach to economic issues, is going to find himself under increasing political pressure to counter his own instincts and adopt a more austere position for the government in the economy. He is likely to continue to delay the hard choices as long as possible, gambling that people would prefer inflation to a hard landing. End Comment.

SELDOWITZ